Supreme Court, U.S.
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No. 02-1842

In The Supreme Court of the United States

CITICORP VENTURE CAPITAL, LTD.,
A New York Corporation,

Petitioner,

v.

COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS, AND COMMITTEE OF CREDITORS HOLDING UNSECURED CLAIMS AS ESTATE REPRESENTATIVE OF PAPERCRAFT CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION

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COUNTER-STATEMENT AND SUMMARY

This case involves the proper application of the principle of equitable subordination to a creditor that, in the Third Circuit's words, engaged in "egregious conduct" and "protracted and unjustified litigation tactics" during a chapter 11 bankruptcy case. (A-11)[1] In spite of Petitioner's efforts to mischaracterize the decisions below as creating a "massive new exception to the American Rule," Petition at 8, they in fact involve nothing more than the application of well-established case law to remedy Petitioner's efforts "to stymie the fair and efficient administration of the [bankruptcy] Estate in an effort to capitalize on its self-dealing." (A-25) The Third Circuit's decision does not conflict with any statute or reported decision of any court. The Petition for a Writ of Certiorari should be denied.

For nearly twelve years, Petitioner has insisted that it did nothing wrong in the Papercraft chapter 11 case. *Six published opinions of the Third Circuit, the District Court, and the Bankruptcy Court unanimously found otherwise.*[2] As found by the Bankruptcy Court after trial, and as affirmed repeatedly on appeal, Petitioner was an insider and a fiduciary of Papercraft, a chapter 11 debtor in possession. In breach of its fiduciary duties, Petitioner secretly purchased more than $60 million of claims against

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[1] Citations to "A-__" herein are to pages of the Petitioner's Appendix.

[2] Each of these opinions is included in the Petitioner's Appendix. A *seventh* published opinion of the Bankruptcy Court was withdrawn by stipulation of the parties, while an *eighth* opinion of the District Court was unpublished. Both these opinions also conclude that Petitioner engaged in extensive misconduct in connection with the Papercraft chapter 11 case.

Papercraft at "extraordinary discounts" (A-158), and while in possession of confidential, inside information. (A-147 – A-149) Petitioner's goal was an illegal attempt to take control of Papercraft's assets. (A-152 – A-153) If left unchecked, Petitioner would have reaped a multi-million dollar profit at the expense of Papercraft's other creditors. (A-81, A-152)

The Bankruptcy Court found that Petitioner breached its fiduciary duties to creditors by, among other things, usurping corporate opportunities (A-155), misusing inside information (A-148), improperly concealing facts from creditors and the court (A-151), and otherwise engaging in conduct "which cannot be tolerated in fiduciaries in a bankruptcy case." (A-153) The Bankruptcy Court further found that Petitioner's misconduct caused Papercraft's creditors millions of dollars in harm through delay, lost opportunities, and additional administrative expenses. (A-72 – A-80) The Third Circuit agreed, concluding that this is "a paradigm case of inequitable conduct by a fiduciary as that concept has been developed by the case law." (A-95)

After a first round of appeals, the Bankruptcy Court on remand ordered that Petitioner's distributions on account of its illegally purchased claims be equitably subordinated under section 510(c) of the Bankruptcy Code[3] to the extent necessary to remedy the harm caused by Petitioner's misconduct. Both the District Court and the Third Circuit affirmed in all respects that are relevant here.

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[3] References to "Bankruptcy Code" herein are to title 11 of the United States Code.

Petitioner does not seek this Court's review of the lower courts' unanimous conclusions that Petitioner breached its fiduciary duties, and that those breaches harmed Papercraft's bankruptcy estate and its creditors. Nor does Petitioner seek review of the lower courts' unanimous conclusions that Petitioner's claims should be subordinated to those of other creditors to account for the substantial harm Petitioner caused during the chapter 11 case. Rather, the *sole issue* presented in the Petition is whether the courts below erred in further subordinating Petitioner's claims based upon the additional litigation expenses Petitioner caused by its "protracted and unjustified litigation tactics" (A-11), including "incessantly relitigat[ing]" issues, submitting evidence "during the litigation that was not credible," and "deplet[ing] monies that would have otherwise been available to the creditors." (A-10) The Bankruptcy Court, District Court, and Third Circuit all agreed that, under the circumstances of this particular case, it was entirely appropriate to consider such expenses in determining the harm to be remedied by equitable subordination.

REASONS FOR DENYING THE WRIT

The Third Circuit's decision properly applies Bankruptcy Code section 510(c) and well-established case law to remedy Petitioner's "egregious conduct" in this case. For more than six decades, this Court has recognized that the claim of a creditor who has acted inequitably may be subordinated to those of other creditors to the extent of the harm caused by the inequitable conduct. In this case, the courts below found overwhelming evidence of Petitioner's misconduct, and that Petitioner's misconduct continued

throughout the course of this litigation. The courts below further found that Petitioner's misconduct harmed Papercraft and its other creditors. Under these facts, subordination of Petitioner's claims to the litigation expenses caused by Petitioner's misconduct was entirely appropriate.

Contrary to Petitioner's assertions, the Third Circuit's decision does not contravene, nor even implicate, the "American Rule" regarding the awarding of attorney's fees to prevailing parties. Respondent was not awarded attorney's fees; nor were attorney's fees assessed against Petitioner. Rather, the courts below held that Petitioner's recovery on its claims must be subordinated to distributions to Papercraft's other creditors to the extent Petitioner's own misconduct harmed those creditors and the bankruptcy estate. Moreover, even if the subordination of Petitioner's claims could somehow be equated to an affirmative award of attorneys' fees (and thus implicate the American Rule), the Third Circuit's decision is entirely consistent with the well-established rule that a federal court "may assess attorney's fees when a party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45, 46, 111 S. Ct. 2123, 2133 (1991) (quotations omitted).

Petitioner has failed to cite a single, appellate level decision supporting its position that litigation expenses may never be considered in determining the extent to which the claim of a creditor who has acted inequitably may be subordinated. There is no conflict among the courts on this issue. Nor is there any other basis for this Court's review. The Third Circuit's decision was proper in all respects.

Respondent respectfully requests that the Petition for a Writ of Certiorari be denied.

A. The Decision Below Involves The Correct Application Of Well-Established Principles Of Equitable Subordination To The Facts Of This Case.

For more than sixty years, this Court has recognized the authority of the bankruptcy courts to subordinate a creditor's claim based upon the creditor's inequitable conduct. *See United States v. Noland*, 517 U.S. 535, 116 S. Ct. 1524 (1996); *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 229, 68 S. Ct. 1454 (1948); *Pepper v. Litton*, 308 U.S. 295, 60 S. Ct. 238 (1939); *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307, 59 S. Ct. 543 (1939). In 1978, Congress codified this authority in section 510(c)(1) of the Bankruptcy Code, which provides that a court may:

> under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest . . .

"Congress included no explicit criteria for equitable subordination when it enacted § 510(c)(1)." *Noland*, 517 U.S. at 539, 116 S. Ct. at 1526. Rather, "Congress intended that the term 'principles of equitable subordination' follow existing case law and leave to the courts development of this principle." *Noland*, 517 U.S. at 539, 116 S. Ct. at 1527 (quotations omitted). Applying well-established case law, this Court has concluded that a claim may be equitably subordinated when: (1) the claimant has engaged in some type of inequitable conduct, (2) the misconduct has resulted

in injury to the creditors or conferred an unfair advantage on the claimant, and (3) equitable subordination would not otherwise be inconsistent with the provisions of the Bankruptcy Code. *Noland*, 517 U.S. at 538-39, 116 S. Ct. at 1526 (citing, among others, *In re Baker & Getty Fin. Servs., Inc.*, 974 F.2d 712, 717 (6th Cir. 1992); *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977)).

The lower courts in this case properly applied this well-established doctrine. Following a three-day evidentiary trial, the Bankruptcy Court issued its opinion that Petitioner breached its fiduciary duties to Papercraft and its creditors by (i) secretly purchasing claims against Papercraft, at a deep discount, without adequate disclosures, and while Petitioner was an insider, and (ii) using its insider position to improperly manipulate the reorganization process. (A-152 – A-154) Among other things, the Bankruptcy Court found that Petitioner, whose representative sat on Papercraft's board of directors both before and during the chapter 11 case, had usurped corporate opportunities and had misused confidential, inside information.

On appeal, both the District Court and the Third Circuit upheld the Bankruptcy Court's findings that Petitioner had breached its fiduciary duties, and that Petitioner's misconduct harmed Papercraft's creditors. The Third Circuit remanded, however, for the sole purpose of allowing the Bankruptcy Court to make factual findings regarding further subordination of Petitioner's claims beyond the $5.4 million profit Petitioner would have made if the claims it illegally purchased had been allowed in full. (A-102 – A-105)

Notwithstanding the limited scope of the Third Circuit's remand, Petitioner attempted to relitigate numerous issues that it had already litigated, and lost, at trial and in two previous appeals. As described by the Third Circuit, Petitioner's "conduct include[d] repeatedly litigating issues that were decided against it in our earlier decision, as well as earlier decisions of the District Court and the Bankruptcy Court." (A-10) Petitioner also engaged in "egregious conduct" such as introducing non-credible testimony and employing "protracted and unjustified litigation tactics that harm[ed] the estate." (A-11) Based upon Petitioner's misconduct, the Bankruptcy Court found that Petitioner's recovery in the chapter 11 case should be subordinated to, among other things, the additional expenses incurred by the bankruptcy estate in connection with this litigation. As reasoned by the Bankruptcy Court:

> the fees at issue depleted funds otherwise available to creditors of this estate due to [Petitioner's] conduct in breach of its fiduciary duty. That is, [Petitioner's] conduct caused the amount available to the estate to pay creditors to be reduced. To assure the creditors the distribution they should have received but for [Petitioner's] conduct, I find it necessary to restore the fund by subordinating [Petitioner's] share of distribution by the amount of fees and expenses incurred by professionals who are to be paid from estate assets that would have not been incurred but for [Petitioner's] breach of its fiduciary duty.

(A-65)

The Third Circuit agreed, holding that Petitioner's claims must be subordinated to those of other creditors in order to account for the additional harm caused by

Petitioner's "egregious conduct" in this litigation. As detailed by the Third Circuit:

> [Petitioner's] inequitable conduct includes repeatedly litigating issues that were decided against it by our earlier decision [in connection with Petitioner's *first* appeal to the Third Circuit], as well as earlier decisions of the District Court and the Bankruptcy Court. For example, in this case, [Petitioner] has incessantly relitigated the issue of whether it profited from its illegal claims trading, even though this issue had already been decided against it in the District Court, and reviewed by us. *In re Papercraft Corp.*, 165 B.R. 980, 983-84 (Bankr. W.D. Pa. 1994); *In re Papercraft Corp*, 187 B.R. 486, 492, 498-99 (Bankr. W.D. Pa. 1995); *In re Papercraft Corp.*, 211 B.R. 813, 825 n.12 (W.D. Pa. 1997); *In re Papercraft Corp.*, 160 F.3d 982, 990-91 (3d Cir. 1998). Also, in the briefs filed with the Bankruptcy Court on remand, . . ., [Petitioner] attempted to relitigate that it did not usurp a corporate opportunity, even though all three courts had already found against [Petitioner] on this issue in previous *In re Papercraft* decisions. 160 F.3d at 987-88; 211 B.R. at 820, 824-26; 187 B.R. at 498-99. Finally, [Petitioner's] collateral proceedings, for which [Petitioner] only had standing because it illegally purchased claims against Papercraft, were aimed at preventing the reorganized debtor from engaging in a value-enhancing sale transaction, and depleted monies that would have otherwise been available to the creditors.
>
> The Bankruptcy Court also determined that the testimony of [Petitioner's] representatives during the litigation was not credible. *In re*

> *Papercraft*, 187 B.R. at 493 n.3 (finding that all other credible testimony and evidence shows that the testimony of [Petitioner's] Saleem Muqaddam is false); *id.* at 497 (dismissing the testimony of [Petitioner's] William Comfort, which contradicted other evidence); *id.* (disbelieving testimony of Muqaddam). Each of these instances of inequitable conduct resulted in legal fees and costs that decreased the funds available to the non-selling creditors.

(A-10 – A-11)[4]

A well-established, and uniform, body of case law makes clear that the purpose of equitable subordination "is to undo or offset any inequality in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of the bankruptcy results." *Burden v. United States*, 917 F.2d 115, 117 (3d Cir. 1990) (quoting *Trone v. Smith (In re Westgate-California, Corp.)*, 642 F.2d 1174, 1177 (9th Cir. 1981); *Bostian v. Schapiro (In re Kansas City Journal-Post Co.)*, 144 F.2d 791, 800 (8th Cir. 1944)). Through equitable subordination, bankruptcy courts have "the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in the administration of the bankrupt estate." *Burden*, 917 F.2d at 117 (quoting *Pepper v. Litton*, 308 U.S. at 308, 60 S. Ct. at 246). The courts' authority to subordinate

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[4] The lower courts reached the same conclusion regarding Petitioner's misconduct in this litigation, finding, among other things, that "it is quite clear that [Petitioner] has acted at every turn to stymie the fair and efficient administration of the Estate in an effort to capitalize on its self-dealing" (A-25), and that "[m]any of [Petitioner's] objections merely restate[d] the issues that were litigated, appealed, and dealt with . . . on remand" (A-59).

claims based upon inequitable conduct is even more present with respect to claims filed by insiders and fiduciaries, such as Petitioner. *See, e.g., Mobile Steel*, 563 F.2d at 701-02 ("We must examine the conduct of fiduciary-claimants 'with a large measure of watchful care.'") (citations omitted; quoting *Washburn v. Green*, 133 U.S. 30, 43, 10 S. Ct. 280, 284 (1890)). When challenged, the burden is on the insider to prove the good faith and inherent fairness of the transaction. *See Pepper v. Litton*, 308 U.S. at 306, 60 S. Ct. at 245.

Applying these well-established principles (which Petitioner does not dispute), the Third Court held that the Bankruptcy Court properly considered the harm caused by Petitioner's inequitable conduct in this litigation. "Although pursuit of one's legal rights may not be grounds for equitable subordination, protracted and unjustified litigation tactics that harm the estate by causing it to incur fees may justify subordination." (A-11) As described by the Third Circuit:

> At trial, the Bankruptcy Court stated that "none of these litigation costs would have been incurred" but for [Petitioner's] inequitable conduct, and that "some reasonable litigation costs may actually be a direct consequence of [Petitioner's] activities in this case." The Bankruptcy Court found that, but for [Petitioner's] inequitable conduct, the Committee would not have incurred such substantial fees and costs. *In re Papercraft Corp.*, 247 B.R. at 628. The Bankruptcy Court analyzed the depletion of available funds in the reorganized entity, and determined that the economic harm is directly attributable to [Petitioner's] inequitable actions. *In re Papercraft Corp.*, 247 B.R. at 628. The Bankruptcy Court

> also found that the fees and costs related to the litigation were a "third type of economic harm caused by [Petitioner's] undisclosed claims purchasing." *In re Papercraft Corp.*, 247 B.R. at 631. The amount of attorneys' fees does not include all litigation costs of the Committee. Rather, more than $700,000 is deducted from the attorneys' fee award for fees and costs that are unrelated to [Petitioner's] inequitable conduct.

(A-9) (certain internal citations omitted)

The Third Circuit gave particular weight to the Bankruptcy Court's first-hand knowledge of Petitioner's misconduct during the nearly twelve years that this litigation has been pending:

> We conclude that the Bankruptcy Court found facts sufficient to establish the egregious conduct warranting subordination of [Petitioner's] claims, and those facts are not clearly erroneous. . . . The Bankruptcy Court has been overseeing this litigation for a decade and has had the best opportunity to observe first hand [Petitioner's] conduct and evaluate its motives. We are hard-pressed to disagree with its determinations based on the extensive record and proceedings before it, and its obvious familiarity with what we previously termed [Petitioner's] "machinations."

(A-11)

As the foregoing demonstrates, this case involves nothing more than the application of well-established principles of equitable subordination to a particularly egregious set of facts. The courts below correctly found that subordination of Petitioner's claims in the amount of the additional litigation expenses incurred by Respondent

serves "to undo or offset any inequality of the claim position" and to remedy "injustice or unfairness to other creditors in terms of the bankruptcy results." *Burden*, 917 F.2d at 117. There is no basis for further review by this Court.

B. The Decision Below Does Not Conflict With The Holding Of Any Court, Let Alone A Holding Of This Court Or Any Court of Appeals.

Petitioner fails to identify a single decision of any court holding that litigation costs may never be considered in determining the amount of a claim to be equitably subordinated. Instead, Petitioner wrongly asserts that "no court has subordinated a bankruptcy claim in the amount of the adverse party's legal fees." Petition at 11. In fact, there are several reported decisions that have included attorney's fees in the amount equitably subordinated.

For example, in *Principal Mut. Life Ins. Co. v. Langhorne (In re 848 Brickell Ltd.)*, 243 B.R. 142 (S.D. Fla. 1998), the bankruptcy court subordinated a creditor's administrative claim to the claims of the bankruptcy trustee for his attorney's fees and costs. The district court affirmed, holding that the trustee's fees and costs had been incurred in fighting the creditor's "protracted and abusive litigation tactics [that] harmed the estate by causing it to incur about $400,000 in fees." *Id.* at 149. Similarly, in *In re Mid-American Waste Sys., Inc.*, 284 B.R. 53, 74 (Bankr. D. Del. 2002), the bankruptcy court subordinated the claims of an insider whose "conduct consisting of a criminal act and breaches of fiduciary duties was inequitable." The court found that the harm caused by the insider's misconduct included, among other things, at least $250,000 in

legal fees, which along with other damages justified the subordination of the insider's entire claim.

The *only* case Petitioner cites for its argument that attorney's fees cannot be used as a basis for equitable subordination is *641 Assocs., Ltd. v. Balcor Real Estate Fin., Inc. (In re 641 Assocs., Ltd.)*, 140 B.R. 619 (Bankr. E.D. Pa. 1992). In that case, the debtor unsuccessfully sought to challenge a creditor's claim. The bankruptcy court found that, even if the creditor had acted inequitably, the creditor's conduct caused no harm to the debtor or its creditors. *Id.* at 627. Indeed, the only "loss" that the debtor suffered was the attorney's fees it incurred in litigating with the creditor. The bankruptcy court concluded that "[t]he fact that the Debtor may have incurred attorneys' fees and was otherwise inconvenienced by contesting Balcor's actions fails to state a cause of action for damages." *Id.*

641 Assocs. is inapposite to the present case, in which Petitioner was found to have engaged in "egregious conduct" both prior to and during this litigation. The Bankruptcy Court found, and the Third Circuit affirmed, that Petitioner's conduct caused extensive harm to creditors far beyond litigation costs. In any event, *641 Assocs.* is the decision of a single bankruptcy court in the Third Circuit, which obviously recognizes that litigation expenses may be considered in determining the amount by which a claim is to be subordinated. To the extent *641 Assocs.* is inconsistent with the Third Circuit's decision below, it is not good law. This Court should not grant the Petition just to address a possible tension with a single bankruptcy court decision with little or no precedential value.

C. The Decision Below Does Not Misconstrue The Court's General Equity Jurisdiction In Bankruptcy.

Petitioner argues that the Third Circuit was "not free to ignore settled law" by invoking equitable principles in bankruptcy. Petition at 11. The Third Circuit, however, never held that it was. To the contrary, the Third Circuit in its two reported decisions faithfully applied well-established law – including more than sixty years of this Court's jurisprudence – to address Petitioner's egregious misconduct.

As discussed above, each of the lower courts applied well-established principles of equitable subordination in this case. Each court found that the equitable subordination of Petitioner's claims was proper because: (1) Petitioner's breaches of fiduciary duty constituted inequitable conduct; (2) Petitioner's misconduct resulted in injury to creditors and conferred an unfair advantage on Petitioner; and (3) equitable subordination was not inconsistent with any other provision of the Bankruptcy Code. Each court found that inclusion of the litigation costs was permitted under principles of equitable subordination and appropriate in this particular case. (A-6 – A-11; A-22 – A-26; A-64 – A-65) Thus, the Third Circuit's decision does not misconstrue the courts' equity jurisdiction or statutory power, and there is no justification for granting the Petition on that ground.

D. The Decision Below Does Not Conflict With The "American Rule".

Petitioner mischaracterizes the decisions below as having "carved out a massive new exception to the American Rule" that parties to litigation generally are to bear

their own attorney's fees. Petition at 8. Petitioner is wrong. As set forth herein, Petitioner has failed to cite a single statutory provision or appellate level decision that supports its argument that the American Rule applies in the equitable subordination context.

Under the American Rule, "the prevailing litigant is ordinarily not entitled to *collect* a reasonable attorneys' fee from the loser." *Alyeska Pipeline Serv. Co. v. Wilderness Society*, 421 U.S. 240, 247, 95 S. Ct. 1612, 1616 (1975) (emphasis added); *see also Chambers v. NASCO, Inc.*, 501 U.S. at 45, 111 S. Ct. at 2133 ("the so-called 'American Rule' prohibits fee shifting in most cases"). In this case, however, Respondent did not collect any attorney's fees from Petitioner, and the Bankruptcy Court did not award attorney's fees to Respondent. Rather, the Bankruptcy Court held that Petitioner's bankruptcy recovery on its claims must be subordinated to the recoveries of the creditors that were harmed by Petitioner's misconduct in an amount equal to the harm Petitioner caused. As discussed above, Petitioner's misdeeds included "egregious conduct" during the course of this litigation and "protracted and unjustified litigation tactics that harm[ed]" Papercraft's reorganization. (A-11) The courts below found that, "but for [Petitioner's] inequitable conduct, [Respondent] would not have incurred such substantial fees and costs." (A-9)

As correctly recognized by the Third Circuit, "the American Rule is not implicated" in this case. (A-8):

> The Bankruptcy Court did not award a money judgment for attorneys' fees to penalize [Petitioner]. Rather, the Bankruptcy Court analyzed the record facts, found specific damages, and used its equitable powers to return the non-selling

> creditors to the position they would have been in had [Petitioner] not acted inequitably.

(A-9)

The Third Circuit's holding is consistent with the holdings of other courts which likewise have recognized that "[s]ubordination is not a recovery for wrongdoing, it involves the exercise of the equitable powers of the bankruptcy court in making distribution of the assets of the Debtor." *Bankers Life & Cas. Co. v. Kirtley*, 338 F.2d 1006, 1011 (8th Cir. 1964) (quotations omitted); *Kansas City Journal-Post*, 144 F.2d at 800 & 805 n.11 (holding that "[s]ubordination does not involve any 'recovery' against the claimant for the inequity which he has committed"; rather, "[s]ubordination is a means of regulating distribution results in bankruptcy by adjusting the order of creditors' payments to the equitable levels of their comparative claim positions."); *see also Minnesota Corn Processors, Inc. v. American Sweeteners, Inc. (In re American Sweeteners, Inc.)*, 248 B.R. 271, 279 (Bankr. E.D. Pa. 2000); *Magnolia Gas Transmission Co. v. MPK Prod. Co. (In re Magnolia Gas Co.)*, 255 B.R. 900, 924 (Bankr. W.D. Okla. 2000) (holding that "subordination is an equitable remedy in which the order of payment, rather than the existence of the debt, is in issue").

Contrary to Petitioner's assertions, the Third Circuit did not hold that "the American Rule is not binding on a bankruptcy court sitting in equity." Petition at 10. Rather, the Third Circuit made clear that it was "considering the *narrow issue* of whether to include professional fees and expenses in the subordination" of Petitioner's claims *in this case*. (A-11) (emphasis added) The Third Circuit made absolutely clear that generally "the pursuit of one's legal

rights may not be grounds for equitable subordination." (A-11) However, "protracted and unjustified litigation tactics that harm the estate by causing it to incur fees may justify subordination." (A-11) Based upon Petitioner's "egregious conduct" in this case, the Third Circuit correctly concluded that further subordination of Petitioner's claims was an appropriate application of principles of equitable subordination, and not a contravention of the American Rule.

Finally, even if the American Rule were to apply to the subordination of a creditor's claim, the subordination of Petitioner's claims on the facts of this case was entirely appropriate. This Court has recognized three exceptions to the American Rule – cases involving "common fund" litigation, cases in which "a court may assess attorney's fees as a sanction for the willful disobedience of a court order," and cases in which "a party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Chambers v. NASCO*, 501 U.S. at 45-46, 111 S. Ct. at 2133 (quotations omitted); *see also Alyeska Pipepline*, 421 U.S. at 258-59, 95 S. Ct. at 1622-23. The third exception clearly applies to Petitioner's misconduct in this case.

As described above, the Third Circuit went to great lengths to describe Petitioner's "egregious conduct warranting subordination" during the course of this litigation. Petitioner's misconduct included the submission of non-credible testimony by two witnesses, endless relitigation of issues that Petitioner had already lost, and "protracted and unjustified litigation tactics that harm[ed]" Papercraft's reorganization. (A-11)

As this Court has recognized, a court "may assess attorney's fees against the responsible party . . . when a

party shows bad faith by delaying or disrupting the litigation or by hampering enforcement of a court order." *Chambers v. NASCO*, 501 U.S. at 46, 111 S. Ct. at 2133 (quotations omitted). This rule applies with full force in the context of bankruptcy proceedings. *See, e.g.*, *Caldwell v. Unified Capital Corp. (In re Rainbow Magazine, Inc.)*, 77 F.3d 278, 284 (9th Cir. 1996) (holding that "[t]here can be little doubt that bankruptcy courts have the inherent power to sanction vexatious conduct presented before the court").

Petitioner's conduct in this case clearly falls within the definition of "vexatious" litigation, including Petitioner's "incessantly relitigat[ing]" issues and other "machinations." (A-10 – A-11) Because the record in this case would have supported an affirmative award of attorney's fees based upon Petitioner's misconduct, it certainly supports the equitable subordination of Petitioner's claims in an amount necessary to compensate Papercraft's other creditors for the harm caused by Petitioner's misconduct. In any event, whether Petitioner's "egregious conduct" was in fact so egregious as to warrant sanctions is not an issue that is worthy of review by this Court.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Dated: July 21, 2003

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